



THE COMPETITIVENESS OF THE BULGARIAN ECONOMY 2001

summary of the annual report

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The Center for Economic Development (CED) has continued to study the competitiveness of the Bulgarian economy, a project to which it assigns priority. The year 2000 saw an analysis of competitiveness on a national level, which was prepared and presented by applying the methodology of the World Economic Forum (WEF). The current report attempts to analyze the transition from competitiveness on a national level to company-level competitiveness, while at the same time delineating the role of the cluster approach in this process.

National productivity is dependent and based directly on the productivity of the firms within a country. The economy of a country cannot be described as being competitive if the companies operating within it are not. Company maturity and performance require better-qualified human resources, better information, more modern infrastructure and competition that is more intensive.

Given the current conditions, companies should change their strategies in order to compete successfully. They should manage to proceed from comparative advantages to competitive advantages because of unique products and processes of better quality and greater value added. What is needed is a change in the goals, practices and strategies.

In countries such as Bulgaria, if efforts continue to be directed solely towards the maintenance of macroeconomic stability, there are bound to be disappointments which will be related to the lack of economic growth. Only by removing the obstacles to the opportunities for increasing productivity, as well as all other policies that obstruct competition, will success and economic growth be achieved. If macroeconomic and financial reforms are the only factors that are relied on, i.e. if companies are not stimulated to improve their strategies and operations, the result will simply be an illusion of progress, while in reality there will be stagnation and a repetition of cycles. In the conditions of overall globalization, globalized capital markets, and the lifting of trade barriers, if companies do not change their attitude, there will undoubtedly be disappointing results, which in the long run are at the root of opposition to globalization. It, however, is an inevitable challenge, that should be taken into consideration by all.

The stable political, macroeconomic and institutional environments create a potential for prosperity. The problem is to provide such conditions on a **microeconomic level that** will allow companies to produce and manufacture goods and services of greater value added by applying methods that are more productive. Such an approach may bring about an increase in wages and return on capital. While the Government and the institutions are concerned primarily with the macroeconomic policy, prosperity and welfare depend on the microeconomic level.

The microeconomic base of competitive power is founded on two mutually connected components: **the quality of the microeconomic environment**, i.e. the environment in which companies actually operate, and **the performance of company strategies**.

Part I of the CED annual report focuses on the assessment of the microeconomic environment. The factors that have a direct bearing on the attitude of companies are organized as follows:

- Fiscal environment
 - Institutional environment and competition on the domestic market
 - Access to financial resources
 - Environment for the development of human resources
 - Infrastructure as an element of the competitive environment.
- Innovation potential
- Liberalization and exports promotion
 - Environment for the development of SMEs

The analysis of Part I is based on the statistical data for 2000-2001, on an analysis of the changes in the legislation, and on a Survey conducted in March 2001 by the CED with the assistance of the Vitosha Research sociological agency among Bulgarian and foreign companies. It also relies on research and investigations of other institutions and organizations, including the 2000 and 2001 reports of the World Economic Forum.

The number of firms covered in the representative Survey exceeds 230. A look at the profile of the firms participating in the study shows the prevailing type of company, i.e. enterprises with a staff of less than 250 employees comprise 44,5%. Firms with a staff of 250 to 500 employees account for 21,8% of the total, while those with a staff of over 500 constitute 22,7%. The firms, whose headquarters are based in the country and which sell primarily on the domestic market comprise 24,4%. The share of companies based in the country and selling both on the domestic and international markets is slightly higher and accounts for 50%; 5,9% are divisions of multinational companies. State-owned companies comprise 10%; government institutions are 8,4%, and the remaining percentage are privately owned companies. Of the overall number, manufacturing companies prevail and form 62%, while 3,4% are engaged in agriculture, 2,5% - in wholesale and retail trade, and 3,4% are engaged in financial brokerage.

The opinion of the business circles on the business environment in the country is quite interesting and serves as an important reference point as to how the government policy is perceived, how the legislation is assessed and how efficiently the government administration is functioning.

MACROECONOMIC STABILITY – THE BASIS FOR PROSPERITY

The greater competitiveness of companies requires that a policy directed towards maintaining macroeconomic stability be pursued and conditions for growth be created. With an annual growth rate of 5,8% of the gross domestic product (GDP), the year **2000 was the most successful** one since the transition period began in Bulgaria.

The macroeconomic dynamics in 2000 surpassed all positive forecasts. The gross domestic product reached a real annual growth rate of 5,8%. On a comparative basis, the GDP level exceeded by 12% the highest level for the period since 1989, i.e. that of the 1997 GDP growth rate. The quarterly changes for the GDP point to steadily increasing growth rates – from 4,8% during the first quarter of 2000, the GDP growth rate reached 6,5% during the fourth quarter of the year. The quarterly trend for 2000 went beyond the average quarterly level for the period 1994 – 2000.

The GDP growth rate in 2000 is determined by both domestic demand, such as household consumption and fixed assets investments, and exporting.

GDP growth in the manufacturing sector was generated entirely by the private sector, whereby the value added increased by 14,2%. The service sector continued to develop steadily. Most impressive, however, is the positive change in the industrial sector, where the value added increased by 15,3% compared to the rather poor performance of the preceding year, i.e. 1999.

In 2000, the industry began to recover, due mostly to the more active exporting activities. The industrial sector value added growth rates in 2000 are positive, being much higher for the third quarter, and especially for the fourth quarter, than the growth rates for the services sector, whose role in determining growth until recently was decisive.

Exports enjoyed a favorable external environment in 2000. Throughout the whole year, the export of goods and services increased at higher real rates than imports did. Exports increased by 24,2% in 2000, while imports – by 14,6%, in comparison with the preceding year. The export and import balance of goods and services, though remaining in the negative to the amount of –5,6% of GDP has improved in comparison with 1999, when it was –7,7% of the GDP.

Investments have continued to increase. In 2000 they were 8% more than in the preceding year, while compared to 1997 they increased by 80%.

The average annual inflation for 2000 exceeded preliminary expectations and reached 10,3%. External rather than internal causes brought about an increase in prices. In 2000, world oil prices remained high and volatile and led to an increase in the price of liquid fuels. The US dollar went up against the euro, thus causing a rise in the cost of import and bringing about an increase in consumer prices.

Unemployment continued to be the most serious problem in the real sector in 2000, in what was an otherwise well-performing macroeconomic framework. After the record-high value of 19% in April, there followed no significant decline to the end of the year, when the level of unemployment stood at 17,9%.

The consolidated fiscal program closed the year 2000 with a deficit of BGL 269 mln, which is –1,1% of the GDP. In absolute and relative terms, the budget deficit is lower than the initially planned one (-1,5%), and is indicative of the good fiscal performance throughout the year.

The total balance of payments of Bulgaria for 2000 is positive, and comes to USD137,3 mln, which is an improvement over 1999.

BUSINESS ENVIRONMENT

Against the favorable background of the macroeconomic framework, the parameters of the business environment point to the following:

Fiscal environment

During the past year, the fiscal policy was the main lever of the economic policy that was used both prudently and flexibly. The major goals of the macroeconomic policy were successfully carried through. The first and foremost goal was to maintain macroeconomic stability, low inflation and moderate current account deficit. Maintaining a low budget deficit proved to be the mechanism in achieving this goal.

The second major goal of the fiscal policy was to maintain and stimulate a steady economic growth, close to the potential one. The mechanism in achieving this goal was the taxation policy that was implemented.

The third goal was to facilitate the structural institutional reforms in the country, i.e. the pension and health reforms.

The implementation of the fiscal policy contributed to achieving a stable balance of payments, steady domestic interest rates, a gradual decrease in tax rates and improved taxation procedures, thus reducing the tax burden and carrying through a policy of more even distribution.

The fiscal policy hitherto conducted and the results achieved have both contributed to improving the business environment in Bulgaria, to stimulating the economic growth and to increasing the competitiveness of companies by implementing an adequate tax policy.

Significant changes and amendments to the tax legislation came into force as of January 1, 2001, their purpose being to stimulate economic activity in the country.

The factors, which are favorable for competition and are related to the tax system include:

- financial stability;
- more favorable tax regulations;
- reduction of the basic income tax rates.

The opinion of the business circles in the country on the taxation policy, as outlined in the March survey, shows that they traditionally view the taxation environment in Bulgaria as being rather unfavorable: 83% of the respondents are of the opinion that the tax system in Bulgaria impedes businessmen from investing and assuming risk. Tax evasion continues to be widespread: 78% of those surveyed are convinced it is possible to evade taxes.

This issue is connected with the “gray economy” in the country: 39% of the respondents point out that the share of unofficial or unregistered business in Bulgaria varies between 20% and 30%. The number of respondents who think “gray” economy is between 30% and 50% is by no means smaller, with 26% of the respondents sharing this opinion. This

is, of course, a subjective opinion, but it is a fact that unofficial business continues to be widespread.

In view of the changes that have already been effected and in view of the forthcoming changes in the tax rates, business assessments will probably change for the better.

It is a fact that due to the macroeconomic stability during the past few years, the government initiated a reform in the tax legislation by integrating the country with European structures. Among the many changes in the tax regime, in force as of January 1, 2001, there are some important ones, which correspond to the needs of the economy.

In future, it is necessary that the day-to-day capacity of the tax administration to ascertain, recognize, accord priority treatment of, and resolve the currently existing problems (ones, which will always exist) pertaining to taxation policy, legislation and practices in Bulgaria be improved. What are needed are purposeful investments in those structures that have the greatest potential in generating quick, liquid, legal and lasting benefits for the state without in anyway negatively affecting the economy. The structures supporting the tax reform should be among the top-priority investment goals. The rapid effect of such investments will generate resources for further reforms.

The important aspects, which call for special attention in aligning the fiscal and taxation policy with the needs of business include:

- Further reducing the overall tax burden by maintaining a low deficit, by not making unrealistic allowances for possible decrease in expenditures, and by not threatening the ongoing reforms. Reducing the tax burden and its more even distribution may be achieved by expanding the tax base and decreasing the tax rates;
- Transferring the relative tax burden from direct to indirect taxes, i.e. from generating income to expending it. In this way, this important instrument of the economic policy will comply with world trends. On the one hand, economic factors will be encouraged to produce more income, and on the other hand, consumption and savings will be balanced, with savings playing a more active role as a source of investments;
- Developing the customs administration with a view to effecting efficient control in compliance with the EU requirements of an external border;
- Setting up a Unified Revenue Collection Agency. It will embrace the collection of taxes and the three types of insurance schemes, i.e. pension (first and second pillar), health, and unemployment;
- Conducting a fiscal policy to optimize government expenditures and observe a strict fiscal discipline;
- Modernizing the system of budget execution by completing and developing the financial management information system (FMIS). This will allow for optimizing the process of planning and executing the consolidated government budget and for efficient functioning of the Treasury;

- Optimizing government supply and rendering public services;
- Allocating resources and defining expenditure priorities efficiently by elaborating long-term programs, by assessing fiscal risk and the effect of expenditures, as well as by formulating measures to balance the budget and maintain revenues on an appropriate level.

Institutional framework and competition

The impact of institutions on business opportunities and on launching keen competition is, overall, more favorable than it was during the preceding year.

The business representatives, who took part in the survey, find that competition on the domestic market is already strong enough and is instrumental in decreasing prices, reducing production costs and increasing the competitiveness of companies by applying an innovative approach.

As of June 1, 2001, the Commission on the Protection of Competition has allowed manufacturers and businessmen to freely enter into agreements, without in any way interfering or approving the conditions of these arrangements. What it prohibits are the negotiation of minimum and fixed prices, as well as the introduction of any restrictions (i.e. with respect to prices, territory and persons the businessperson may choose to deal with). This will facilitate business, as the Commission will not be required to provide permits. It will only continue to monitor and make sure there are no fixed or minimum prices in the contracts, which would allow monopoly to be established.

A particular feature of the domestic market is the fact that currently competition is due primarily to imports, and not to domestic production; over 60% of the companies are of this opinion. It no doubt has an effect on Bulgarian companies, but it also reveals the problems they face in the process of restructuring of the national economy.

The respondents are, to a large extent, unanimous in their opinion with respect to the nature of competition and the state of the domestic market: the appearance of competing firms on the market is a frequent phenomenon; it is not, however, connected with the launching of a new business. Despite the administrative measures that have been taken and the fact that quite a few regulating acts restricting business have been abolished, starting a new business is considered extremely difficult, time-consuming and accompanied by a lot of red tape, which make it costly as well.

The opportunities of starting a new business in Bulgaria are judged as being unfavorable. An analysis of the results against the background of the remaining countries included in the WEF Report shows that for the second year in a row Bulgaria ranks last in the list. At the same time, a closer study of the assessments shows that 75% of the companies give low marks to this indicator, i.e. between 1 and 3. Further on, in the opinion of 19% of the respondents the number of permits and licenses required to start a new business depends on the nature and field of activity and comes to a total of 10; there are even some, slightly over 4%, who point out that 20 permits and licenses are required.

The time necessary to set up a new business in Bulgaria, in the opinion of 28% of the respondents, is 30 days; 14%, however, think that 60 days are necessary. This delay causes difficulties for penetrating the market. According to experts, who assess the potential of countries to raise their competitive power, one of the major factors, along with innovative potential and access to funding, is the opportunity to start a new business. Difficulties in starting a new business weigh heavily on Bulgarian business and give rise to corruption.

A fairly large percentage of the respondents (nearly 60%) thinks that often enough, when taking decisions relating to a particular policy or to the signing of contracts, the ruling circles favor certain companies or persons, which in fact clearly indicates the lack of impartiality and objectivity.

Another factor, which as a rule stimulates company competition, is the **exacting nature of buyers in the country**. It makes companies resort to innovation, offer high quality products, provide services of good quality and variety. In Bulgaria, according to 60% of the respondents, buyers are not demanding and this accounts for the lack of stimuli to enhance competition.

It should, however, be pointed out that the business circles think the Bulgarian consumers are, to a certain extent, inclined to seek and adopt new products and technologies; more than 1/3 of the respondents, i.e. 35%, give an above-the-average mark.

As to the issues relating to the **antimonopoly policy** in the country, 56% of the participants in the survey think this policy does not stimulate competition efficiently. Company expenditures have been on the increase because of unfair competition; 37% give an affirmative reply, while 21% declare they have not been affected by such phenomena.

The opinion of the Bulgarian business circles on **corruption** is optimistic. Asked whether the practice of giving bribes (additional payments for obtaining public and other services) is widespread, it is quite impressive that the percentage of those who replied in the negative, meaning that they do not pay bribes, is quite high, i.e. over 50%, provided, of course, they answered the question sincerely. Moreover, they think that during the past three years the frequency of paying bribes has dropped; 37% think this rate has not increased, while more than 18% think it has gone down. According to 70% of the respondents, expectations for the spread of corruption over the next few years are that the level of giving additional payments or bribes will decrease. The number of those who think the giving of bribes will spread further is much smaller; only 12% think this will happen.

The legal system and the police force, in the opinion of entrepreneurs still fail to act as an ally to business: 63% of the respondents find the **legal system** in Bulgaria is not independent and is influenced by intervention on the part of the parties to the dispute. The existing legal mechanisms make it difficult and cumbersome for businesses to contest the lawfulness of government actions or regulations and to resolve and adjudicate disputes quickly and impartially.

More than 65% think the **police force** cannot be relied upon for efficient protection against criminal acts; organized crime (racketeering, extortion) still causes serious problems to business and 63% of the respondents think in this way.

Access to financial resources

Entrepreneurs still think unfavorably of financial markets in Bulgaria; over 85% of the respondents find the financial markets in Bulgaria are at a rather low level of development. In the opinion of 84% of the respondents it is difficult, if not impossible, to obtain a loan by presenting a good business plan. According to 72%, it is impossible for entrepreneurs with innovative, though risky projects to find venture capital in the country. Modern methods of settling payments are not popular; settlements in real time through the Internet are possible only in the opinion of 74% of the respondents; 63% think the banking institutions do not effect banking transactions through the Internet.

At the same time, however, business circles assess the financial stability of banks as being satisfactory; 74% of the respondents think this is so. Forty-five per cent of the surveyed think it was easier to obtain a credit during the past year, while 41% think there is no change at all in the situation.

An objective analysis of the banking system shows it is currently characterized by stability and reliability. The main factors that have a bearing on this fact are:

- The improved legal framework, the active supervisory role of the Bulgarian National Bank, and the consequences of the 1996-1997 crisis which have been surmounted, create a good potential for further developing this sector;
- The banking sector demonstrates a very high level of liquidity, capital adequacy and quality of the credit portfolio;
- Confidence in the sector has been gradually increasing and for 2000 alone deposits of non-financial institutions and households have risen by BGL 1,2 billion;
- The Bulgarian National Bank exercises strict supervision and prevents the banking sector from systematic risks;
- Competition on the banking market is gradually becoming stronger.

At the same time, factors such as the access to financial resources continue to function and have a negative effect on the competitive position of Bulgarian companies.

- The ratio of bank assets to GDP is still very low;
- Banks continue to implement a conservative credit policy, the reasons for this being both external and internal;
- Interest rate on credits retains relatively high levels, and because of the poor credit activity no serious changes are expected;
- The rate of interest spread is still very high, i.e. within the range of 9% to 10%, which has a negative effect on real economy;

- Banks still have a rather low level of profitability, which is in fact a concealed threat to the future development of the sector;
- Commercial banks still find it difficult to manage expenditures on their activities and need more efficient and modern management of these expenditures;
- The banking market is slow to develop and lacks a great number of products and services;
- The banking sector remains static and conservative with respect to the real economy.

Environment for human resource development

The current CED survey assesses human resource development through a microeconomic approach to competitiveness. This approach presupposes that several important spheres be emphasized:

- Correspondence between labor force qualification and the needs of production;
- Relation between wages and productivity;
- Flexibility of the labor market;
- Discrimination of some groups of workers.

The overall assessment of the human resource sphere is lower than what it was in past years when the survey was conducted, and when human resources were defined as being a potential advantage of the Bulgarian companies. The lower assessment that business circles give to the competitive power of the human factor is due primarily to the emphasis laid on labor force qualification in the field of information technologies and the possibility of finding realization within the country. Assessing the labor force performance in Bulgaria has been changing in view of the new technological environment: it is no longer defined as highly qualified but rather as highly educated and qualified to work with obsolete technologies. This definition signals the need of a persistent government policy of investing in human resource development, including both target government programs, as well as stimuli for the companies that invest in the further training of their personnel.

Furthermore, the survey results point out that the labor market is relatively flexible. It is employers that determine the practice of hiring or dismissing workers; 50% of the respondents think this is the case. There also prevails the opinion that companies also freely determine wages.

The criteria on Bulgaria's accession to the EU set new requirements to the quality and conditions of free movement of workers within united Europe. The strategy of human resource development should meet the modern technological and social realities through specific regulatory and administrative measures, among which the following have the highest priority:

- To provide a flexible profile and adjust the structure of vocational institutions and establishments of higher education to the needs of the labor market;
- To develop the system of professional orientation;
- To expand the access to higher education by granting credits to students;
- To coordinate the qualification and training programs for the unemployed through a system of monitoring and quick response to the disproportions of the labor market;
- To offer appropriate training and qualification programs to risk groups on the labor market, among which people with low level of education, ethnic groups, handicapped people, etc.;
- To acknowledge the regional priorities in elaborating qualification and training programs, with a view to approximating them to the specific needs of the local labor market.

Infrastructure as an element of the competitive environment. Technologies and innovative potential

The availability, the satisfactory condition and efficient management of infrastructures are of utmost significance for the steady economic growth and the competitiveness of Bulgarian companies. During the past years the processes of liberalization, privatization and building a regulatory framework that would create conditions for a competitive environment cover the infrastructure sectors as well, i.e. telecommunications, transport, energy and water supply, which until recently were perceived as natural monopolies. The restructuring of the infrastructure sectors may attract considerable foreign investments, which in turn will have a positive effect on the economic development and the company competitiveness.

During the past three years **the assessment Bulgarian business circles give to the effect that infrastructure has on competitiveness has been steadily rising** by 11% to 12% compared to the levels of the previous year. More than 1/3 of the entrepreneurs report that in 2001 infrastructures did not impede the development of business. The tendency to improve the impact of infrastructures on the business environment is confirmed by a study of KPMG, according to which 55% of all foreign investors in 1998 considered infrastructures an obstacle to investments in the country, while in 2000 their share dropped to 40%.

At the present stage, infrastructures in Bulgaria support the competitiveness of Bulgarian companies. Their positive influence is based primarily on the reasonably good communication, transport, energy and water supply systems. Bulgaria is currently facing the task of further expanding the qualitative parameters of the infrastructure environment it inherited and of transforming these into a long-term generator of economic growth. Firstly, the solution should be sought in the **priority development of the information and communication environments**, which underlie economic growth. Developing these

infrastructures may prove to be the driving force behind company prosperity and the rapid progress of the Bulgarian economy.

According to most businessmen who took part in the survey, developing and introducing information technologies stands a strong chance of becoming the top government priority. At the same time, however, the specific programs, inasmuch as they exist, in the opinion of 50% of the participants are inefficient.

The assessments of entrepreneurs confirm the fact that there are certain prerequisites for technological development in the country. For example, Bulgarian managers give a generally high mark to education in the field of mathematics and natural sciences. Regardless of the difficulties that education in Bulgaria faces, this assessment has been increasing over the years. The research institutes and research organizations also receive a relatively high mark. Entrepreneurs have a slightly different opinion on education in the field of information technologies. Only 5% think it corresponds to that in the leading countries.

Bulgarian business highly values the research, engineering and technical personnel in the country as an important prerequisite for technological development. At the same time, however, 76% of the participants point out that there is a lasting tendency for these specialists to seek professional realization abroad.

Entrepreneurs think Bulgaria continues to lag behind in terms of technological development. The assessment of Bulgaria's position in the field of technologies retains the low level of previous years, showing only a slight tendency towards improving.

The government's policy to stimulate company R & D is found to be unsatisfactory. More than half of the participants in the survey emphasize the fact that companies receive no direct government subsidies and tax credits to carry out research activities. Government commissioning does not have a strong enough effect on the development of the innovation processes, since for the most part awarding these commissions is price-rather than technologically related. Business circles also give a very low mark to the cooperation with local universities in the field of research and the process of launching new products. Only 5% of the surveyed assess this process as intensive and continuous.

The limited access of Bulgarian companies to venture capital is confirmed by 70% of the participants who respond negatively to the statement that entrepreneurs offering innovative though risky projects may, in principle, raise venture capital in Bulgaria to finance these projects.

According to 57% of the respondents, government services may not be performed through the Internet. Most entrepreneurs think the laws pertaining to the information technologies, i.e. e-business, e-signatures, consumer protection, do not function efficiently.

Public access to the Internet is relatively limited in the opinion of 44% of the respondents, but there is a prevailing opinion that it is available through libraries, Internet

centers and clubs (more than 50% think this is so). Access to the Internet in schools, however, is considerably more limited, with 65% of the respondents thinking in this way. 76% of the respondents think there is no competition in the field of telecommunications. As for transport, things are a somewhat more favorable: 50% think there is competition and that it brings about a better quality of services.

The research findings confirm the fact that despite certain progress in technological development, the country needs to take specific measures to stimulate this development through both government and company policy. As regards government policy, these measures aim to:

- Coordinate the national strategies on the development of technologies in different spheres (high technologies, information society, research, education);
- Elaborate regional initiatives to stimulate innovations;
- Support the participation of Bulgarian companies in international scientific projects, mainly within the EU (framework projects, EUREKA, etc.);
- Rationalize and coordinate the activity of the networks that support the development of business and transfer of technologies and have been developed under various international programs;
- Facilitate the access of companies to financial resources for the purpose of technological development.

On company level, technological development presupposes carrying out a technological audit in order to appraise the technological state of the company, as well as mapping out specific measures to improve it, which should be included in the company's business plan. In this way, technological development and innovation may turn into a planned rather than a sporadic activity. The European Innovation Center (EIC), which has at its disposal a pool of experts in various fields, may render assistance in carrying out the technological audit and undertake a considerable part of the expenses made.

It is necessary that the **implementation of new high technologies in all infrastructures** be promoted, which, in the long run, will raise the efficiency of their exploitation and will improve the quality/price ratio for the end users.

Investments in new technologies are inextricably bound up with attracting foreign investments in the infrastructure sectors. On the one hand, this process will bring about a more efficient exploitation of the infrastructure environment, and on the other hand, it will stimulate investments in other sectors of the economy.

Rapid and successful restructuring is of utmost importance for attracting the interest of foreign investors to the Bulgarian infrastructure sector. Abolishing the monopoly structures and allowing privately owned companies to participate in the management of infrastructure systems will stimulate competition in the sector and ensure better quality of water supply, telecommunication, transport and energy services, all of which are an important element of the end products and of the channels of access Bulgarian products have to the international markets.

Establishing new relations among infrastructure operators requires that independent regulating organs begin to function, i.e. bodies, which can discharge their obligations adequately. The setting up of competent, politically unbiased and independent bodies will guarantee the interest of investors and consumers and will stimulate the development of infrastructure services, and hence support competition.

The Bulgarian economy can rely on a stable flow of strategic foreign investments only if there is a clear, long-term and transparent policy of infrastructure development, and if there is a stable regulatory framework. Only under such conditions will foreign investors be willing to assume risks and provide services of better quality and, at the same time, at accessible prices to their clients.

Bulgaria could improve its competitiveness by putting to better use the advantages it has due to its geographic location, and by further integrating the telecommunication, transport and energy infrastructures with the all-European infrastructures. An integral part of this process is the coordination of the Bulgarian policy on infrastructure development with the priorities of the neighboring countries.

Liberalization and export promotion

Liberalizing the economy, opening the domestic market to the competition of imports by reducing duties on imports, gradually lifting non-tariff barriers, limiting the number of irrelevant requirements concerning standards, environmental protection norms, phytosanitary measures and water safety measures contribute to raising competitive power and consumer exactingness, improving production efficiency by introducing innovations and reducing costs, and finally, to raising the competitive power of companies. Lessening domestic market protection stimulates the development of the country's export potential and brings about accelerated economic growth.

The entrepreneurs, who took part in the survey, assess the liberalization of the economy as being satisfactory. In their opinion, the hidden barriers to imports are not a big problem, while the costs incurred in paying duties, licensing and banking charges, and administrative services, raise the cost of imports by 20% to 30%. The number of documents required to effect commodity exports has dropped considerably (to 4 to 5 in most cases). Companies consider the stable exchange rate, the easy access to the foreign currency needed, and the relatively low costs in acquiring it as the greatest relief. The high exchange rate of the US dollar also has a favorable effect on the growth of exports and the rise in competitive power of companies.

The changes that have already been made have nearly approximated customs procedures with EU legislation. However, the main ongoing problem that the customs administration now faces is their implementation. There are quite a few cases when at the different border crossings different procedures are applied, thus not only violating legal norms but diverting the usual flow of commodities as well. The *centralized information system* which is currently being built and which should cover all 120 customs terminals has not

yet been completed, making it, therefore, impossible to check the movement of goods across the borders. It is expected that by the end of 2002, it will be possible to complete and synchronize the computer systems controlling imports and exports with those of the border and tax authorities. These systems are expected to reduce to the minimum the possibilities for smuggling and to eliminate the unfair competition due to smuggled imports.

Trade liberalization and reduction of the customs burden have been running smoothly in compliance with all commitments that have been assumed. The ultimate goal is duty-free trade with preferential partners from the EU, CEFTA, EFTA, or those with whom agreements have been concluded or with whom free trade agreements are due to be signed, as well as the alignment of “general tariff” rates with those of the EU by 2007. This is the period Bulgarian manufacturers have at their disposal to raise their competitive power and learn to operate in a market which lacks the government’s protectionist tariff protection.

Having in mind the open nature of the Bulgarian economy and the direct dependence of economic growth on the rise in exports, it is only natural that **measures promoting exports** be taken. For the time being, the contracted consumption on the domestic market and the strong competition of imports because of the liberalized market are the only stimulus. Under such restricting conditions, manufacturers are trying to find an appropriate niche (though highly restricted) on the external markets where they can effect their yet poor competitive advantages.

For the purpose of stimulating exports, in mid-2001 experts from the Ministry of the Economy put up for discussion a draft project entitled “Foreign Trade Strategy for 2001 - 2005”, whose key task was to promote exports. This strategy is complied with the obligations ensuing from Bulgaria’s membership in the WTO, the European agreement on association it has signed, and other international agreements. In preparing this strategy, world experience in export promotion was applied. It provides for:

- Easing the conditions for participating in the foreign trade turnover;
- Improving the services rendered to exporters on the part of government institutions in charge of this process;
- Reducing the expenditures incurred by exporters along the various stages of a foreign trade deal;
- Introducing European standards rapidly; providing broad public participation in elaborating the standards and in winding up the process of introducing European standards;
- Improving and providing exporting-related information.

Attention has been paid to the necessity of perfecting the institutional framework for promoting exports through enhancing structurally the institutions engaged in export promotion, further developing the products and services offered, and making popular the products and services provided by the institutions in charge of export promotion.

Specific measures to stimulate exports and the activities of export-oriented companies are presented for the first time. These measures aim to comprehensively cover the system of

assisting export, to optimize the expenditures on providing government aid and its utilization by economic subjects, to ensure easy access to information on the regulatory base in the field of foreign trade, to set up an accessible data base on the technical requirements of certain markets, to enter manufacturing and exporting companies in a data base, thus allowing them to be classified according to certain criteria for the purposes of government foreign trade goals, to pass information on to prospective partners, to provide information to the companies in the data base about important events, changes, and other facts.

The measures hereto offered are structured along five major lines: financial levers, administrative and legal frame, information and research activities, promotional activities, and developing an institutional frame. An attempt has been made to schematically outline the institutions and their tasks in assisting export.

The plan presented by the Bulgarian Export Insurance Agency (BEIA) aroused great interest. It provides for comprehensive services to exporters on the basis of a single product, called “base policy”, where an insurance policy may serve as such, since taking out such a policy means that the company has the necessary insurance and meets certain criteria. It will make it possible for other BEIA products to be used preferentially, such as guarantees to obtain bank credit, to refinance interest rates on foreign trade credits, to use information freely or to participate in international trade events, as well as other forms of preference. This idea indicates the government’s commitment and its serious intention of elaborating and implementing a comprehensive plan to aid exports.

It is not clear, however, what the possibilities of the government are to implement the proposed plan and the measures it lays down, what resources it will rely on, and what organizational activities will be undertaken. The lack of synchronization and relatedness of the activities and information systems among the various government institutions, as well as the somewhat vague place and role of each of the participating government institutions (at least at this stage), will most probably prevent it from being introduced quickly and comprehensively. In the opinion of a wide range of experts and representatives of the business circles, there is one measure, which is both easily applicable and efficient in view of promoting exports. This pertains to reducing the period for claiming back VAT by export-oriented companies to no more than 15-20 days. Such a step will make it possible to set resources free for companies to operate with, and will rule out the need to seek special measures for additional financing of the exporting companies.

Improved conditions in 2000 brought about a record high inflow of **foreign direct investments** (FDIs). Their structure has improved and investments “in the green” already exceed 50%. Investments in the financial sector and high value added industries are on the increase, too. In a number of sectors (e.g. commerce, esp. a chain of shops), the competition of foreign companies on the market has already affected and resulted in reducing costs, improving management and introducing innovations in order to enhance the competitive power of Bulgarian companies.

As assessed by the foreign investors, who are members of the Bulgarian International Business Association (BIBA), the business environment in Bulgaria has further developed and progressed during the past year to greater transparency, more stable legislation and more relaxed conditions. The greater part of the investors, however, still claim that the current economic policy does not stimulate the private sector to invest. The obstacles, as pointed out by the investors, relate primarily to government administration red tape, to the unfavorable depreciation policy, and to the difficulties, foreign citizens encounter in buying land. The non-transparent privatization process, the insufficient protection of creditors' rights, the insufficient development of the insurance market, the inefficient legal system, etc., supplement this list.

Environment for SMEs development

The efforts to enhance the competitive power of the economy and to accelerate the growth rate are further supported by the sector of small and medium-sized enterprises (SMEs). The analysis of the conditions for emerging and developing SMEs in Bulgaria, defined by the current regulatory frame and the government policy in support of the sector, as well as by the specific measures to surmount some of the more serious problems in this field, is conducted in view of Bulgaria's preparation for accession to the European Union.

Bulgaria has joined the EU program on promoting SMEs, and has embarked on a process of harmonizing its legislation in this direction. The results achieved were acknowledged during the negotiations on Bulgaria's association to the EU with the successful closing of Chapter 16, i.e. "Small and Medium-sized Enterprises", in 2000. Despite this fact, however, it is obvious that the current normative base needs to be changed and supplemented, and its implementation needs to be improved, in order to create a favorable environment for entrepreneurial development and to reach full alignment with EU legislation. The 2000 Regular Report of the European Commission on Bulgaria's Progress towards Accession¹ recommends that the definition of the European Commission on SMEs be adopted, especially with respect to the size of micro-, small, and medium-sized enterprises. This change would result in:

- Increasing the maximum number of people employed in medium-sized enterprises to 250 (while at the same time raising the upper levels for annual turnover and tangible assets' worth) will expand the scope of the sector to over 99,9% and, in practice, will cover the entire real sector of the economy, as is the case in all other EU countries.
- Specifying the criteria for independence will allow venture capital funds, institutional and portfolio investors to partake in more than 25% of the capital of a SME without affecting its status. This will increase the possibilities to provide alternative non-bank financing to business, to attract foreign minority investors, especially for medium-sized enterprises, as well as to raise the investment options of the licensed pension insurance companies.

- Abolishing the restriction that general partnerships should be neither small nor medium-sized enterprises to the effect of the Law on SMEs, will create more opportunities for attracting additional financial resources.

The National Strategy on Promoting SME development, currently under way, as well as the draft project of the new strategy for the period 2001 – 2006, assign top priority to the task of creating an environment that will enable SMEs to grow, profit and become competitive.³ The draft project lists the following three priorities:

- Simplifying SMEs administrative and legislative norms;
- Improving financial services for SMEs;
- Improving the competitive environment and SMEs competitive power.

It should be pointed out, however, that the priorities of the current National Strategy now in force, as well as the ones laid down in the draft-project, fail to clearly formulate measures to promote SMEs engaged in high technologies, as well as SMEs engaged in R & D, which the Law on Small and Medium-sized Enterprises^{4 ii} explicitly provides for. No measures are envisaged to build a science park and apparatuses for establishing SMEs.

COMPANY STRATEGIES

A look at the second equally important component of company competitiveness, i.e. **company activity and performance of strategies**, shows that the competitive advantages of Bulgarian companies are due to the low labor costs. Seventy-eight per cent of the respondents report this fact, while only 5% of the companies state their advantages are due to the unique products and processes they offer. More than 70% of the companies report, that manufacturing makes use of obsolete technologies. Thus, one of the main problems Bulgarian companies face with regard to competitive power is to increase productivity based on modern technologies and innovations. The advantages founded on cheap labor are not strong and may be lost at any one moment as new companies from different countries are appearing on the market all the time, and they all surpass the Bulgarian companies in this respect. It is necessary to outline advantages, based on technologies, uniqueness of the processes and products, and high quality of the goods and services on offer. The capacity of companies to be innovative together with the possibility to start a new business determine, to a large extent, the competitive power of companies.

It should be pointed out that the interest a great number of the Bulgarian companies take in technological renovation and manufacturing new products has been gradually growing. Thus, for example, the survey conducted by the Federation for Entrepreneurial Development on emerging clusters shows that more than half of the companies under study in the wood-processing and furniture industries, the textile companies, companies producing ready-made clothing, as well as canning enterprises are all planning to innovate.

According to the entrepreneurs surveyed, following the methodology of the World Economic Forum in Davos, more than 63% of the participants in the survey introduced a new product or service, or changed their method of production considerably during the past five years. A similar conclusion may be drawn on the basis of the EIC study. More than 40% of the interviewed manufacturing enterprises introduced a new technology and a new product at the same time.

The share of companies that do not consider the need for continuous innovation an important factor to generate revenue remains quite high. Entrepreneurs do not assess highly the important role innovations have for the further development of their business activities. They assess the introduction of new technologies in very much the same way. Only 25% of the businessmen think the companies in the country may be described as aggressive or energetic in their efforts to introduce new technologies, while 40% share the opposite opinion.

There are different sources for technological renovation; buying new equipment, however, prevails. Acquiring patents and licenses is deemed helpful though not widely used in the transfer of technologies. The predominant part of the Bulgarian entrepreneurs, who took part in the survey, i.e. over 70%, defines this source of technological

development as atypical to the conditions in Bulgaria. The EIC survey reports that only about 13% of the companies bought patents and licenses.

As regards the influence of foreign investments on the technological development, the results are very much the same. The percentage of managers who think that direct investments have only a slight effect on further technological development prevails over the number of those who are inclined to consider it as an important source.

Technological development is financed mainly through companies' own resources. Expenditures on research are not typical of the predominant part of the Bulgarian companies. Only 5% of the interviewed report they allocate funds for research activities. This, of course, comes to bear on the kind of innovations they make. The EIC survey shows that companies that conducted innovation activities during the last three years prior to the survey effected 2 to 3 innovation activities, with new design elaboration and trial production prevailing.

Joint research activities are not a priority for Bulgarian companies in their cooperation with foreign partners. Trade activities are what prevail. That is why the willingness of some companies to take part in joint research projects in case they find appropriate partners may be assessed as a positive trend.

The Bulgarian companies are well informed about the new technologies that are currently being developed. The EIC survey shows that the lack of information about new technologies is not an obstacle to innovations. Most companies use more than one source of information, with company printed matter and customer surveys being the most important ones. Obtaining information via electronic modes is still somewhat limited. This conclusion is in line with the assessment of managers on the use of electronic means with respect to their external correspondence, as well as the rather limited investments of most Bulgarian companies in the information and technological abilities of their staff.

Regardless of the opportunities that the macroeconomic frame creates for business strategy development, most companies still carry on their business intuitively, i.e. without strictly defined goals and ways to achieve them. This fact predetermines the lack of a clear strategy on technological development, which is typical of most companies covered by various surveys. Therefore, it may be concluded that technological development in the country depends largely on raising the level of business culture, on managerial skills and abilities of the Bulgarian entrepreneurs.

The study of innovation activities shows a trend similar to the trends in other East European countries. With companies where foreign partners have control over management, the Bulgarian branch carries into effect the innovation and technological policy of the main office.

The lack of resources to finance and the high expenditures incurred are still the main barriers to innovation activities and technological development. Both the EIC survey and the 2000 Report of the Agency for SMEs make this conclusion. The latter point out that more than 61,8% of the so called dynamic SMEs consider the lack of financing a key issue; it is followed by inappropriate production equipment – 23,7%, and knowledge

about new technologies – 21,1%. Other factors impeding innovation include lack of information about the markets where company products may be realized.

The survey results on the quality of **marketing** in Bulgaria are negative (it comes last in the list of the WEF Report), with more than 70% of the respondents thinking in this way. Along with other problems and because of the lack of quality marketing strategies, the export-oriented companies in Bulgaria have directed their exports primarily to one or several international markets, i.e. their production meets the needs and requirements of a limited circle of consumers, and it may be difficult to direct it to more markets.

Another group of factors that have an effect on the competitive positions of Bulgarian companies are connected with the **human resource** management. Companies pay insignificant attention to the development, improvement and qualification of human resources. This problem has been brushed aside; there are few, if any, investments in the further qualification and training of the staff; more than 50% of the interviewed think no attention is paid to this issue, i.e. the potential for future development is ignored.

The managerial staff lacks the desire to delegate rights to their subordinates; 75% see no such inclination in managers. The number of respondents who think that top managerial posts are awarded to acquaintances and/or relatives of the owners and/or top management is quite high, with 65% sharing this opinion.

The performance of schools and management education and training is reported as being low, with 65% being of this opinion. These are issues, which have a great impact on the formation of strategies of high quality for company management and company transactions.

Important conclusions:

Weak aspects of the competitive environment and company strategies

- Low level of efficiency of some institutions (e.g. the legal system, the police force);
- The existence of administrative barriers and bureaucracy;
- Serious difficulties in setting up a business;
- Lack of financial resources;
- Competition on the domestic market, which is not sufficiently keen;
- Buyers, who are not exacting enough;
- Low level of implementing modern methods of communication and trade;
- Lack of a deliberate company policy on human resource qualification and investments on further training and education;
- Low level of marketing strategies;
- Lack of sufficient professional expertise in managing companies (e.g. poor management);
- The main competitive edge of companies – cheap labor force rather than high quality of products and services on offer;
- Lack of established clusters.

Strong aspects:

- Macroeconomic and financial stability;
- Stability of the banking institutions;
- Reform of the tax system, aiming to stimulate business;
- Some flexibility of the labor market;
- Optimistic expectations on reducing corruption;
- High level of economic liberalization;
- Relatively good performance of standards;
- High level of education in the natural sciences;
- Qualified scientists and engineers (according to word standards).

CLUSTERS

The **second key point** in the CED report focuses on the possibilities of creating competitive clusters. Clusters are a new concept for the countries in transition, including Bulgaria, and have only recently become the subject of analysis and comments.

Experts and the authors of the Global Competitiveness Report at the World Economic Forum think the presence of clusters in a country is of great importance for high competitiveness. Clusters are, in fact, a concentration of companies in a given sphere, together with their suppliers, manufacturers of interrelated products or suppliers of interconnected services and specialized institutions located in the same country, e.g. the Silicone Valley in the USA, the shoe and leather industry in Italy.

In Bulgaria, the idea of clusters is practically unknown. Nearly 10% of the interviewed have not answered the question if there are clusters in Bulgaria. This may be interpreted to mean they have never heard of such a concept. More than 70% of the respondents give a negative reply to this question, i.e. they think there are no clusters in Bulgaria.

Unfamiliarity with the cluster system calls for an analysis. Clusters develop when companies invest actively in establishing supplier and buyer networks, and in shaping innovative strategies. In the developing countries, competing companies act as driving forces behind clusters. Once the link units in a cluster have been identified, a stage where government policy may play an active role, the development of a cluster is directed towards rendering assistance on corporate level, in order to make managers more competitive and make them participate in developing clusters on a national level.

Clusters are a group of supporting and connected industries, where the link between them is effected through buyers, consumers, suppliers and other intermediaries, working together to support, innovate and improve the quality of a given product or service. Recognizing the important or potentially important clusters in a given country is of key significance in establishing the area, in which a country may achieve growth or welfare. This is one of the important tasks this report undertakes to fulfill: to argue and prove the potential of the two sectors, which may turn out to be of extreme significance for the prosperity of Bulgaria's economy, i.e. the software and tourism industries.

The basic steps in developing cluster competitiveness include:

- Establishing the potential of an existing cluster;
- Describing a cluster in detail and determining the key companies and industries affecting the development of the cluster;
- Studying the quality and positioning the products and services offered by companies within the cluster;
- Evaluating to what extent the production process and the supply of services is developing efficiently within the cluster;
- Elaborating industrial marketing programs;
- Advancing a strategy to join the globalization process.

What lies at the core of a cluster is creating an environment of inter-company cooperation. In a number of cases, the links within a cluster are activated through the transfer of technological initiatives, supply and other links, which support and promote innovations and further stimulate inter-company cooperation and cluster competitiveness. The lack of cooperation and confidence within a cluster may cause difficulties and affect competitiveness unfavorably; it may lead to the manufacture of products and services that lack competitiveness.

The current survey analyzes two potentially competitive sectors of the economy and the opportunities of transforming them into growth-generating clusters. These sectors include the **software and tourism industries**.

The present study may serve to elaborate a modern policy on achieving economic growth. Analyses such as this one have been conducted in many industrially developed countries. This fact makes it possible to identify the clusters that have already been formed and that are operating successfully, as well as the ones that carry considerable potential for development. It is on this basis that governments later shape their economic and innovation policy. This policy presupposes several consecutive steps: agreement to conduct an industrial policy based on the cluster approach; in-depth analysis of the respective sectors and the extent to which they are characterized by connection and interdependence; selection of prospective sectors; building a strategy and drafting programs.
